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Foreign Corrupt Practice Act and U.K. Bribery Law: Detect and Prevent Bribery

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Foreign Corrupt Practice Act and U.K Bribery Law

Detect and Prevent Bribery

Brandy Gonzalez

Executive Summary

Corruption has impacted the world, from consumers losing confidence in the economy, to companies losing out on major deals due to high corruption cost. Today bribery is hitting headlines weekly, becoming more prevalent in today's society.

Through research and data, this paper analyzes the effectiveness of the Foreign Corrupt Practice Act and the UK Bribery Act of 2010 for the elimination of bribery. The goal of this paper is to show how companies and the government are not actively preventing bribery.

The first chapter provides a fundamental background of the Foreign Corrupt Practice Act, the creation of the Organization for Economic Co-operation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the UK Bribery Act of 2010, and a brief background on the Whistleblower Improvement Act of 2011. The second chapter describes bribery's impact on enterprises and the way they prevent and can future protect their companies. The third chapter shows how auditors can help prevent and detect corruption within organizations. The forth chapter is an interview with Reed Gardiner, a retired partner at PricewaterhouseCoopers. The fifth chapter shows how the government is shifting their focus on prevention, as well, it shows how users are being affected by bribery. It also contains my conclusion on the situation.

Chapter 1: History

Corruption is a great challenge for both the United States, and other countries worldwide. Bribing public officials for the benefit to expand one's company can be considered a "social evil that is undermining the stability of societies, endangers democratic and moral values, and retards economic advancement."¹ It is affecting public respect for laws as well as the structure and stability of the economy. In a survey of 350 international companies done by Simmons & Simon, a global law firm, about 20% said corruption could account for half or more of the total project cost; this could really hinder a company's opportunity to for future growth.² Major incidents, such as the Watergate scandal, have caused a major change to the corporate laws within the United States, and in effect have changed laws worldwide. In 1977 the Foreign Corruption Practice Act was created in direct response to the Watergate incident to fight bribery and corruption in the United States; in all 1988 the U.S. government negotiated with the Organization for Economic Co-operation and Development (OECD) to expand anti- corruption worldwide. In 2011 in efforts to strengthen their fight against foreign bribery, the United Kingdom enacted the UK Bribery Act 2010, which affected both the UK and US companies.

Foreign Corrupt Practice Act

Regulation of corruption in the United States took center stage after the Watergate scandal in 1972. With Nixon up for reelection, the Committee for Re- election of the President

¹ Brannen, Laurie. "Upfront: The High Cost of International Bribery." *Business Finance*. January 1, 2007. <http://businessfinancemag.com/article/upfront-high-cost-international-bribery-0101> (accessed April 3, 2012). Sanyal, Rajib. "Determinants of Bribery In International Business: The Cultural and Economic Factors." *Journal of Business Ethics*, 2005: 139-145.

² "Anti-Corruptions." *United Nations Global Compact*. <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/anti-corruption.html> (accessed October 10, 2011).

was discovered to have taken to funded illegal wiretapping of the Democratic National Committee in the Watergate office complex in Washington DC. Amidst the scandal it was also found that Attorney General John Mitchell controlled a secret slush fund that was used to pay off the wire tappers and financed other efforts to gather intelligence about the opponent. Though Nixon was re-elected despite press coverage of the Watergate incident, he eventually resigned facing impeachment with his connection to cover up the break-in.

As an outcome of this major scandal, the SEC began more investigations into corruption and bribery. The SEC believed the corporate contributions was misleading and the amounts should be disclosed. In return, the SEC initiated enforcement and volunteer disclosures³. The response was large finding 400 corporations admitting to some form of corruption amounting over \$300 million dollars to foreign officials, politicians, and political parties⁴. Of the 400 companies that self- reported, over 117 of the companies ranked in the top Fortune 500 companies⁵. So on December 19, 1977, the Foreign Corrupt Practices Act (FCPA) was put into law "to restore public confidence in the integrity of the American business system."⁶ by putting an end to bribery of foreign officials.

The FCPA has two main provisions: the accounting provision and the anti- bribery provision. The accounting provision amends section 13 (b) of the Securities Exchange Act of 1934, requiring companies who register their securities with the Securities and Exchange

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Adler, Tamara. "Amdending the Foreign Corrupt Practices Act of 1977: A Step Toward Clarification and Consolidation." *The Journal of Criminal Law and Criminology*, 1983: 1740--1773.

⁴ "Foreign Corrupt Practices Act: Antibribery Provisions." *The United States Department of Justice*. <http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-gulde.pdf> (accessed 10 October, 2011).

⁵ Welsmann, Miriam F. "The Foreign Corrupt Practices Act: The Failure of the Self-Regulatory Model of Corporate Governance In the Global Business Environment." *Journal of Business Ethics*, 2009: 616-661.

⁶ "Foreign Corrupt Practices Act (FCPA) and Other Anti-bribery Measures - Ex-Im Bank." *Export-Import Bank of the United States*. <http://www.exim.gov/products/policies/ForeignCorruptPracticesActFCPAandAnti-briberyMeasures.cfm> (accessed October 10, 2011).

Commission (SEC) and companies that have American Depositary Receipts to maintain detailed and strict recordkeeping and internal controls. The stricter record keeping requires that all issuers "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."⁷ Strict internal control requires that a system be enacted to provide "reasonable assurances that transactions are executed in accordance with management's general or specific authorization."⁸ These actions ensure the assets of the company are used for the company business.

The anti-bribery provision is just that-- a prohibition against bribery by United States companies. Bribery of foreign officials, political party officials, and candidates for political office to obtain business, directing business to others, or securing any improper advantages, is illegal for all companies registered or not registered with the SEC. Bribery is defined as any offer of payment to any foreign official with the knowledge that the payment will sway their decision, cause them to omit or to do an act in violation of his duty, or to secure any advantages with a country⁹. Additionally, the FCPA prohibits corrupt payments through intermediaries, agents or joint ventures, while knowing that all or some of the payment will go to a foreign official. However, there are some exceptions to "grease payments" made to foreign officials, such as securing the performance of a "routine governmental action." As well, if the company has less than 50% of voting power, the parent and the subsidiary doing business in the foreign venue is not covered by the FCPA.

⁷ Jordan, Jon. "Recent Developments in The Foreign Corrupt Practices Act And The New UK Bribery Act: A Global Trend Towards Greater Accountability In The Prevention Of Foreign Bribery." *NYU Journal of Law & Business*, 2011.

⁸ Ibid

⁹ Ibid

Violations of the FCPA can lead to both civil and criminal penalties enforced by the Department of Justice (DOJ) and the SEC. Civil penalties include fines exceeding \$10,000, and additional fines not to exceed the gross amount of pecuniary gain or a specified dollar limitation ranging from \$5,000 to \$500,000¹⁰. In some cases a person or business violating the FCPA can be barred from conducting business with the federal government. Criminal penalties for FCPA violations include fines up to \$2 million for business and corporations, and \$100,000 for individual's, as well as up to five years imprisonment¹¹.

After the FCPA went into effect it faced heavy criticism. Since U.S. companies were the only ones to be affected, they lost business opportunities and were at a disadvantage compared to other countries that routinely gave bribes. In order to deal with the problems, the government set two plans--First it created the Title V of the Omnibus Trade and Competitiveness Act of 1988; second, it negotiated with the OECD to create an international law similar to the FCPA.

The Omnibus Trade and Competitiveness Act maintain the two major provisions of the FCPA, but introduce minor changes to the rest. It eliminates any criminal liability imposed for violation of accounting principles unless management knowingly failed to implement reasonable controls. The Act makes no changes to third party payments; however "willful blindness" can no longer be used as protection. Additionally, the intentions of bribery are altered to include, "influencing any act or decision of such foreign official in his official capacity, or inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official"¹².

¹⁰ "Foreign Corrupt Practices Act (FCPA)." *Federal Criminal Lawyer : White Collar Crime Lawyer- David Benowitz*. <http://www.whitecollarattorney.net/foreign-corrupt-practices-act.html> (accessed January 12, 2012).

¹¹ Ibid

¹² "Foreign Corrupt Practices Act." *Welcome to the America Information Web*. March 3, 1999. http://usinfo.org/enus/government/branches/crs_fcpa.html (accessed October 10, 2011).

The OECD negotiation took over ten years to implement; in December 1997, thirty- three countries signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions in Paris. This was a huge success on the part of the United States; it put all of their companies on a more level playing field with those in other countries. However, amendments were necessary to make the laws in the OECD Convention consistent with the FCPA. This includes expanding the criminalization of payments, which before only stated to influence any decision of a foreign official or to induce him to do or omit to do any act, to now include "any improper advantage." The FCPA's definition of "public officials" was expanded to include officials of public international organizations. Lastly, the elimination of the restrictions stating only issuers with securities registered under the 1934 Securities Exchange Act and "domestic concerns", the FCPA would apply to foreigners who commit bribes while in the US.

Corruption is inevitable, governments can only set guidelines and hopes for the companies to follow and implement their own regulations. The Foreign Corrupt Practices Act of 1977 has transformed into a mutual law amongst thirty-three other nations through the OECD and continues to grow with the increase of regulations in other countries, such as the United Kingdom and continues to grow. The FCPA has created a stable base to prevent corruption, however, with the gaps in the law it can never be eliminated.

U.K. Bribery Act 2010

The U.K. Bribery Act 2010 is said to be "the largest regulatory change in global anticorruption law since the U.S. Patriot Act in 2001."¹³ The old bribery laws in England and

¹³ Deloitte poll

Wales were considered outdated and unspecific; with pressure to revise their laws from the working group, the OECD's group responsible for monitoring compliance, the United Kingdom (UK) created the UK Bribery Act 2010--which came into law on April 8, 2010 and became enforceable on July 1, 2011. The Act provides a consolidated scheme of offenses by which bribery and corruption will be repealed by bringing more enforceable actions against bribery. The UK Bribery Act contains three sections: general bribery offences, bribery of foreign officials, and failure of commercial organizations to prevent bribery.

Under the section of general bribery offenses there are two types of offenses-- bribing another person and accepting a bribe. A person is guilty of bribing another person if performing one of the following actions: offering, promising or giving a financial or other advantages to another person with the intent to induce a person to perform an activity improperly, or to reward a person for the performance of such an act, or promising or giving a financial or other advantage to another person, where the person knows or believes that the acceptance of the advantage would in itself constitute the improper performance of a function¹⁴. In both cases it does not matter whether the advantage is offered, or given by the person directly or through a third party it is still considered bribery.

An offense for accepting a bribe occurs if one of the following four cases applies: one party requests or agrees to accept a financial or other advantage in exchange for an improper performance, the acceptance or request for the advantage is an improper activity, one person offers the other a reward for an improper performance, or one person performs an improper activity in anticipation for an advantage. An "improper performance" in summary is explained by a "performance which amounts to a breach of an expectation that a person will act in good

¹⁴*Bribery Act 2010*. United Kingdom, April 8, 2010.

faith, impartially, or in accordance with a position of trust.”¹⁵ Local custom or practice is to be disregarded when looking at improper performance, unless written law states otherwise.

The UK Bribery Act states that it is now required to prevent bribery as an internal control, known as due diligence, and it has created a new corporate criminal liability. This section of the Act affects multinational companies the most. If a person associated with an organization commits bribery under any of the above situations, the organization is held liable. If however, a company puts into place adequate procedure designed to prevent persons associated with the organization from committing bribery, the company is protected. This law can apply to any company or partnership that carries on any part of its business in the UK even if the bribery has no other connection with the UK.¹⁶ Penalties under the UK Bribery Act include imprisonment up to ten years with an unlimited fine.¹⁷ However, the Act does not state how the fines will be implemented, which causes great worry.

The UK Bribery Law does not apply to all countries within the United Kingdom. In places such as England, Wales and Northern Ireland there must be consent by the director of the Serious Fraud Office and the Directors of Public Prosecution within each country for any case to bring up against any company. The biggest effect on United State companies is the strict liability of a prevention program. These countries will use the Code for Crown Prosecutors to make their decision about applying a two stage test of whether there is sufficient evidence to convict a

¹⁵ Pyne, Matthew. "BRIBERY ACT 2010." *Ministry of Justice*. June 21, 2011. <http://www.ukbriberyact2010.com/Assets/Resources/MinistryofJustice-Circular-BriberyAct2010.pdf> (accessed February 27, 2012).

¹⁶ *Bribery Act 2010*. United Kingdom, April 8, 2010.

¹⁷ "UK Bribery Act: Raising the Bar." *Deloitte*. 2010. http://www.deloitte.com/assets/Dcom-Russia/Local%20Assets/Documents/PDF_2011/dtt_UK_Bribery_%20Act_EN.pdf (accessed 27 2012, February).

prosecutor and if it is in the public's interest to convict the person.¹⁸ If a US company has a subsidiary in the UK it can be found guilty of the "corporate offensive," even if the offense was committed outside the country by a non- UK employee.¹⁹ Companies without UK subsidiaries or UK operations are not directly affected by the new laws. However, if in the future a company wants to do business with the UK they must abide by this new act.

Differences between FCPA and UK Bribery Act

Although very similar to one another, the FCPA and the UK Bribery Act have some differences. For instance, the FCPA's major offenses are bribery of foreign officials and failure to maintain books, records and accounts. US domestic concerns (US citizens, US corporations, etc), even for operators wholly within the US are required to follow the rules within this regulation. The UK Bribery Act's major offenses are offering or accepting a bribe, bribing a foreign official, and failure to prevent bribery, and it applies to a person committing the act within the United Kingdom, or a person committing the act overseas, but has close connection to the UK. The UK Bribery Act makes it illegal to accept a bribe, this is a major difference from the FCPA.

Whistleblower Improvement Act of 2011

In the recent years whistle blowing has made a big presents in the business world. Whistleblower laws have been imbedded within many acts in the past; some laws included Clean Air Act, Energy Reorganization Act, Federal Water Pollution Control Act, and Sarbanes-Oxley Act. Each laws has their own guidelines, however, in 2011 the Whistleblower Improvement Act

¹⁸ "Bribery Act 2010: Joint Prosecution." *Serious Fraud Office*. 2010.

<http://www.sfo.gov.uk/media/167348/bribery%20act%20joint%20prosecution%20guidance.pdf> (accessed April 03, 2012).

¹⁹ *Bribery Act 2010*. United Kingdom, April 8, 2010.

of 2011 came into effect to modify certain provisions relating to whistleblower incentives and protection. The Act defines who a whistleblower is and the information that needs to be presented to the government, along with the criteria's that need to be met to receive a reward. A whistleblower is defined as an individual, who alone or jointly with others, provides the SEC with information that relates to potential violations of federal securities law.²⁰ People believe the changes will help encourage workers to bring cases up; however, many are being retaliated against.

For instance, Kazuo Okada, co founder of Wynn Resorts, filed suit on Wynn Resorts in January for an improper payment to the University of Macau Development Foundation, which sits on a governmental property. Months later Wynn Resorts sued Okada for improper payments to the Philippine Amusement and Gaming Corp. Wynn Resort then forced Okada to sell his shares at a discount and are in the process of taking him off the board. Okada had whistle blew on Wynn Resorts and in return was sued, although the Whistleblower Improvement Act gives incentive for people to bring up cases, when it comes to bribery situations can become complicating. Especially with the new UK Bribery Act of 2011 it is hard to see the exact affects the two will have on each other, either for better or for worst.

²⁰ Crites, D. Michael, and Christian Gonzalez. "Dodd-Frank: Final Whistleblower Provisions Take Effect August 12th - Is Your Company Ready?" *National Law Review*. July 31, 2011. <http://www.natlawreview.com/article/dodd-frank-final-whistleblower-provisions-take-effect-august-12th-your-company-ready> (accessed April 2, 2012).

Chapter 2: The Enterprise

In order to stay within regulations set forth by the Foreign Corrupt Practice Act, which set the US at a disadvantage to international companies that can freely bribe to obtain new contacts, prevention and detection systems within an enterprise are key. Management in an enterprise has a big effect on the amount of corruption in ones company. The tone management sets, as well as the internal controls and prevention program an enterprise enacts will help eliminate the chances of bribery. Reed Gardiner, retired partner from PricewaterhouseCooper, stated that the attitude the board of director sets will have a drastic effect on the way a company is run--if the board of directors is not involved and do not have the street smarts to properly run a company, bribery will be more prevalent.

Overview: Direct Effects

U.S. companies lost billions of dollars in deals internationally to companies that were bribing after the enactment of the FCPA in 1977 and the effects continue currently. The United States, before the UK Bribery Act, had the strongest laws against bribery globally. In recent years, enforcement of the FCPA has shifted, deterring companies' desire to enter new businesses with companies that have not operated under the act previously due to changes in the SEC regulations. The SEC has redirected its regulation on the FCPA--focusing on companies with agents and on specific individuals rather than on corporations²¹. In the past five years alone, enforcement actions have increased by nearly four times;²² a there are 33 countries signed in to the OECD Convention, some have no filings against companies while others have only had one

²¹ Koehler, Mike. "The Foreign Corrupt Practice Act in the Ultimate Year of its Decade of Resurgence." *Indiana Law Review*, 2010: 390-412.

²² *International business attitudes to corruption – survey 2006*. Survey, Simmons& Simmons, 2006.

or two in the past decade. The FCPA has had a major impact on companies as a whole, causing them to lose millions of dollars in business with other countries.

As with all laws, there are unforeseen effects and the FCPA is not any different. With the new law many companies had to implement new compliance and anti- corruption programs that caused an increase cost on the enterprises, as well the increase risk of exposure to enforcement action and related costs. Companies also faced a larger cost in overcoming the burden to contend with competing businesses that were not susceptible to these rules and costs. Thirty-five percent of US companies believe they are losing out on business opportunities due to failure to recruit new business away from competitors' bribes.²³.

Thus, overall there were good intentions for the FCPA, but companies are being hit with numerous costs associated with the implications. Additionally they are losing business to competitors and are unwilling to enter into new business ventures in some countries due to the increase in risk with stricter regulation by the SEC.

Detection and Prevention

The FCPA requires companies to redesign their internal prevention and detection controls to help detect bribery while creating a new anti- corruption program to fight against the potential for future bribes. A company should begin with understanding the COSO Framework to better enhance internal controls, which in effects help detect bribery since bribery is governed by internal controls. Then the company should create an anti corruption program to prevent bribes.

The COSO Framework consists of five interrelated components: control environment, risk assessment, control activities, information and communication, and monitoring. Control

²³ *International business attitudes to corruption – survey 2006*. Survey, Simmons& Simmons, 2006.

environment sets the tone of an organization, which directly affects the mind set of all employees within. Control environment factors include integrity, ethical values and competence of the entity's people. Although this is a part of the COSO Framework, this is very important in the fight against bribery as well. If the tone of the company is set to actively stop bribes, there is potential for the company to lack the presence of bribery. The opposite is true as well, if the tone is not strict, agents and employees are more likely to engage in bribes and pay off foreign officials. Through risk assessment is analysis outside risk factors, such as the economy or other competitors, that can affect the company and determines how the risk should be managed. Risk is always changing as the industry and economy changes, thus the risk assessment program must actively adapt. Control activities are policies and procedures to ensure management is taking actions to manage risk and achieve the entities' objectives, including segregation of duties, verification, etc. Information and communication entails gathering and distributing important information in a timely fashion to allow people to fulfill their responsibilities²⁴. Documents include financial and compliance information, produce reports and other information used to run the business smoothly.

Lastly, monitoring insures the quality of the systems performance. This is an ongoing process done with operations. Management and supervisors regular activities performed daily are an example of monitoring. Combining all these steps allows a company to integrate a strong internal control program required by the FCPA, while giving companies a strong platform to develop an anti- corruption compliance program. Bribery is preformed within the controls of the company, thus have a concrete understanding of the controls allows for a stronger defense.

²⁴ "Internal Control - Integrated Framework." *COSO*. 2004. <http://www.coso.org/documents/Internal%20Control-Integrated%20Framework.pdf> (accessed November 17, 2011).

Once a company has an understanding of internal controls it can gain a perspective on what an anti- corruption compliance program should seek to achieve-- prevention. Many enterprises have adopted new process within their companies to actively fight against corruption and give their shareholders more confidence. Large companies including, the Big 4 accounting firms, Coca- Cola, Best Buy and many others, have joined in the World Economic Forum Partnering Against Corruption Initiative (PACI); " a global anti-corruption initiative, developed by companies for companies."^{25,26} Transparency International, a global civil society organization developed by PACI, develops a business principle framework to help companies design an effective system to fight against bribery. The framework states, "Enterprises should implement anti-bribery programs both as an expression of core values of integrity and responsibility, but also to counter the risk of bribery."²⁷ Risk varies from industry to industry, but no one will ever be free from it entirely. The framework consists of six steps: deciding on a no-bribe policy and implementing a program, planning the implementation, developing the program, implementing the program, monitoring, and evaluating the program.

When a company starts to develop a program, the first step is committing to the prohibition of any form of bribery. The company needs to create a culture that does not tolerate bribery, as well as commit to implementing the program once established. The second step is to make sure the program is clear and shows in detail the policies and procedures that prevent bribery to ensure no misunderstandings. It should be tailored for their company's culture and

²⁵ "World Economic Forum." *LIST OF SUPPORT STATEMENT SIGNATORIES*. September 2011. http://www3.weforum.org/docs/WEF_PACI_SupportStatementSignatories_2011.pdf (accessed October 30, 2011).

²⁶ "Partnering Against Corruption Initiative." *World Economic Forum*. <http://www.weforum.org/issues/partnering-against-corruption-initiative> (accessed June 23, 2011).

²⁷ "Business Principles for Countering Bribery." *International, Transparency*. February 2009. http://www.transparency.org/global_priorities/private_sector/business_principles (accessed June 21, 2011).

firm characteristics, such as size, industry and location of operations, and needs to fully appreciate all outside variables that will alter during implementation.

The third step is developing the program and its scope. This should focus on the firm specific risk, which is risk only significant to that one company; however, there are some things it should include at a minimum. Bribes can be manipulated directly through an enterprise or through third parties, such as agencies and joint partnerships, thus the program needs to prevent both direct and indirect bribery. Programs should ensure that no one in an enterprise including the enterprise, the employees, or the agents, should arrange or accept any bribes. This includes bribes directly or indirectly given to political parties, any contributions donated otherwise should be displayed for all to see. Enterprises need to make it clear and ensure any charitable contributions or sponsorship is not used as bribery. Lastly, enterprises should not allow the acceptance of gifts or hospitalities that can be perceived as bribery.

The next step, very key, is implementation of the program. Implementation is key to ensuring an enterprise is actively fighting bribery. Transparency International's suggest implementation strives to hit every level of personnel involved in the organization. To start, the organization responsibility consists of the top personnel, the board of directors (BOD) and the CEO. The BOD should commit to a program and provide leadership, resources and active support of the program; the CEO is responsible for carrying out the program. The organization must identify repercussions for violations and stick with them to show their commitment to the program. Before entering into new business ventures, the company needs to ensure the new business practices utilize the same business ethics, and if not, make sure the new entity adopts the same culture. It must present the business its compliance program and have an exit strategy if the business fails to abide. Agents should not be used to channel improper payments either, an

agent must read and agree to the compliance program and provide proper documented due diligence before a company can appoint an agent. When entering into contracts with suppliers and business contractors, companies need to look at the history of integrity; if the new company has committed illegal or immoral acts in the past, the risk of business and the threat of bribery occurring are high. Additionally companies should make new business partners aware of their policies so they understand the position of the company on the situation. Lastly when hiring new employees the company needs to make the hires aware of its stance and keep current employees educated on the anti- corruption policy.

The fifth step is monitoring, which can be done by either an internal and external auditor. Monitoring is necessary to ensure the framework is working properly and is reviewed regularly. The last step is evaluation and improvement to ensure the program is actively fighting corruption effectively. Employees and employers must be able to raise concerns of violations freely within a supportive system that eliminates fear of reprisal, in order for the program to be successful.²⁸

Implementation of such a program framework seems rather simple; however it poses problems for companies to implement. Companies such as Sheppard Mullin and Foley have created programs to advise companies fearful of violating either the FCPA or the UK Bribery Act. They advise companies on anti-corruption statutes around the world.

Statistics of Bribery Implications

Since the implementation of the FCPA in 1978 to 2008 a combined SEC and DOJ total of 106 cases were brought to the surface, with proportionally more in recent years. On average from 1978 to 2000 one to two case were brought up, while from 2001 to 2008 an average of five to six

²⁸ Ibid

cases were brought up each year. Government agencies have lack implementation in the past, as well, compliance programs within organizations are also not very strong. Three main problems with in corporations' fights against corruption are: auditing of third parties for compliance, performing due diligence on third parties, and variation in country requirements²⁹.

Last year KPMG took a survey of 214 executives in the US and UK to identify their most vexing anti- bribery and corruption (AB&C) compliance challenges and to understand how companies are preventing, detecting and responding to AB&C risk. Even with all guidelines, one in five US and UK companies do not have communication and training programs; more than one in three in the US and one in four in the UK stated that training for employees is less frequent than once a year³⁰. Two in five respondents who have written AB&C policies do not distribute these policies to agents, vendors and joint venture suppliers; more than one in two US and two in five UK respondents do not obtain periodic compliance certifications from agent distributors, vendors, brokers, joint venture partners, or suppliers. Additionally an article by EY has stated "A full 40% of executives admit that they rarely perform bribery or corruption due diligence, even though more than half are seeking growth opportunities in regions where the corruption risk is high³¹." Transparency International, 13 leading practices in corporate governance showed that companies generally performed less, not more, monitoring of their overseas operations than at home. It also found that 52% of the respondents had multilingual versions of compliance plans available and only 19% rated their codes as "extremely effective."³²

²⁹ *Global Anti-Bribery and Corruption Survey*. Survey, KPMG, 2011.

³⁰ Ibid

³¹ "Global bribery and corruption fraud risks." *Earnst & Young*. 2011.

<http://www.ey.com/GL/en/Services/Advisory/Global-bribery-and-corruption-fraud-risks> (accessed February 20, 2012).

³² "Report On Application Of The Convention On Combating Bribery Of Foreign Public Officials In International Business Transactions and The 1997 Recommendation On Combatting Bribery In International Business

Companies are still having problems implementing their anti-bribery programs, even with the assistance of frameworks such as Transparency International. Corporations lack control over their agents, the most prevailing person who performs bribes, and are not strict with the implementation of their programs. In return bribery still has a strong presence. If corporations are having trouble implementing their programs, even with new laws, what will allow this to improve? Until the companies take serious action and follow the frameworks, bribery cannot be minimized.

Example:

In recent years the SEC has increased the number of enforcement acts within the US. For instance in 2005 the SEC sued Titan Corporation, a San Diego, California based military intelligence and communications company, with violating the anti-bribery, internal controls and books and records provisions of the Foreign Corrupt Practices Act (FCPA)³³. Titan had never implemented a formal company-wide FCPA policy, disregarded the FCPA policies and failed to have meaningful oversight over their foreign agents this causing them to end up in this situation. The SEC complaint stated that Titan funneled about \$2 million to the election campaign of Benin's president to assist in the development of a telecommunication project in Benin³⁴. Although Titan neither admitted nor denied the allegation, the company agreed to the entry of a final judgment permanently enjoining it from future violations of the FCPA. Titan was required to pay \$13 million in fines, as well pay \$15.5 million in disgorgement and prejudgment

Transactions." *OECD*. October 2002. <http://www.justice.gov/criminal/fraud/fcpa/docs/oecd-Phase-2-report.pdf> (accessed April 3, 2012).

³³ "Sec Sues The Titan Corporation For Payments To Election Campaign Of Benin President." *Security Exchange Commission*. March 1, 2005. <http://www.sec.gov/news/press/2005-23.htm> (accessed December 17, 2011).

³⁴ Welner, Tim. "Titan Corp. to Pay \$28.5 Million In Fines to Forgin Bribery." *New York Times*. 2 March, 2005. <http://www.nytimes.com/2005/03/02/business/02titan.html> (accessed December 2, 2011).

interest³⁵. They are required to retain an independent consultant to review the company's FCPA compliance and procedures and to adopt and implement the consultant's recommendations³⁶.

Titan as a result lost a \$2.2 billion buyout offer from Lockheed Martin, later being bought out by L-3 Communications. However, when the original bailout failed, Titans shocks dropped 20% in affect hitting their investors.

³⁵Welner 2005

³⁶ SEC: 2005-23

Chapter 3: Auditors Preventions and Detections

While enterprises have a big role in the prevention and detection of bribery, auditors, both internal and external, and governmental agencies have a duty too. They monitor the actions of management and to determine whether they are following policies.

Auditor

Internal and external auditors both hold strong roles in the prevention of bribery. Internal auditors' responsibilities are to help management control the detection programs for bribes, while ensuring that management implements both internal controls and risk management programs. External auditors have more responsibility in detecting material misstatements within the statement and to educate management when they are unaware of the problems.

External Auditors:

Over the years new regulations have been implemented to ensure external auditors are detecting misstatements. In October 2002 the AIPCA issued the SAS 99: *Consideration of Fraud*. According to SAS 82 auditors were required to, "specifically assess the risk of material misstatement of the financial statements due to fraud in every audit (fraud consists of misappropriation of assets and fraudulent financial reporting, including bribery).³⁷" SAS 99 required auditors to seamlessly blend consideration into their audit process and continually update it until the audit is complete. SAS 99 composed a three step process where auditors must gather information to determine the risk of misstatement due to fraud, evaluate the risk after

³⁷ Mancino, Jane. "The Auditor and Fraud." *Journal of Accountancy*. April 1997.
<http://www.journalofaccountancy.com/Issues/1997/Apr/mancino.htm> (accessed November 1, 2011).

reviewing the controls and respond to the results³⁸. SAS 99 requires companies to stop relying heavily on a company and have skepticism, discouraging bias over the audit. Auditors are required to redesign their process to include a "brainstorming" section to understand the company more thoroughly, to determine how a fraud might be perpetrated within a company, and how it might be concealed. This brainstorming section is designed to help audit teams determine their own "tone at the top" to ensure all members are going into the audit with skepticism³⁹. SAS 99 gives new means of identifying risk as it provides guidance to obtain information from management and others within the organization, analytical procedures, and consideration of fraud risk. Several questions to ask management about their understanding of fraud, fraud risk and the steps they take to eliminate fraud are given within the standard. Since these questions are new for companies, auditors may be required to inform management of the risk, meaning and prevention of fraud. Analytical procedures allow auditors to examine the change and outliers and determine if and where the fraud may be located. Overall, fraud is more prevalent when elements of the fraud triangle (pressure to commit fraud, opportunity is available, and the rationalization that fraud is not bad) are present, thus an auditor needs to use their own judgment to help determine if these risk are significant. SAS 99 have changed the requirements of external auditors, demanding they redesign and use their own judgment to narrow down if and where fraud would be located.

In the situation where an external auditor finds fraud they must first bring it to management's or the board of directors' attention, if it is material whether or not. Once they are aware of the fraud, auditors need to take into consideration the effect on the remaining financial

³⁸ Ramos, Michael. "Auditors' Responsibility for Fraud Detection." *Journal of Accountancy*. January 2003. <http://www.journalofaccountancy.com/Issues/2003/Jan/AuditorsResponsibilityForFraudDetection.htm> (accessed November 1, 2011).

³⁹ Mancino, Jane. "The Auditor and Fraud." *Journal of Accountancy*. April 1997

statements and determine if they can rely on the information presented to them. If not, they should withdraw from the audit. If however, reliance on management is not altered, then the financial statements must be restated and the processes continued.

External auditors have the duty of examining the financial statements and ensuring there is no material misstatements, either fraud or misappropriation of assets, within. They must use their own instincts along with procedures to ensure that companies are not concealing fraud. They also have the duty of educating management on what fraud, identifying, and preventing, if management is unaware of the situation. With new regulations for external auditors, they are more observant and aware of the risk of fraud.

Internal Auditor:

Internal Auditors are in possession of critically sensitive information that is important to the company. This information can include threats, uncertainties, fraud and misrepresentation. If this information were to become public it could alter a company's reputation, image, market value of investment, or earnings. However, under the Institute of Internal Auditors (IIA), internal auditors' governing body, the code of ethics requires them to keep this information confidential. Since the enactment of Sarbanes- Oxley internal auditors are to be even more on the radar of seeking fraud than before. An internal auditor has a professional duty and an ethical responsibility to carefully evaluate all evidence and the reasonableness of the information they acquire and decide whether further actions are needed to protect the organization's interests and stakeholders, the outside community, or the institutions of society⁴⁰.

⁴⁰ "Communicating Sensitive Information Within and Outside the Chain of Command." *The Institute of Internal Auditors*. 2010. http://www.Internlaudit.cz/download/lppf/Practice_Advisory/PA%202440-2-AJ.pdf

If an internal auditor encounters fraud within the financial statements they must decide what the next step is; they may seek the advice of legal counsel or in some circumstances they must immediately inform the board of directors, who then will determine the next action taken. Internal auditors also have the option to inform outside of the normal chain of command, otherwise known as a whistleblower. Information communicated outside the chain of commands must be backed by creditable information for the action to move further.

One way for internal auditors to affectively monitor companies is using a program called Anti- Bribery and Corruption (ABC) analytical to help better examine companies. This system uses accounting data inputs to track trends and potential abnormalities. It uses statistics to look for key risk areas and is designed to highlight suspicious or potential improper activities before the internal auditors' on site visit⁴¹.

According to research done by the IIA, internal auditor's responsibilities are more to detect misappropriation of assets than to seek out corruption⁴². Internal auditors have the obligation to determine whether management is properly implementing their governance programs. They evaluate internal controls, to see if the management's tone eliminates any opportunity available to associates, as well as managers, in committing fraud. It is important they determine if internal controls are efficient; this includes the responsibility of detecting and preventing corruption within corporations⁴³. In addition, they understand that they must devote

⁴¹ "Global Bribery And Corruption Fraud Risks." *Earnst & Young*. 2011. <http://www.ey.com/GL/en/Services/Advisory/Global-bribery-and-corruption-fraud-risks> (accessed February 20, 2012).

⁴² DeZoort, Todd, and Paul Harrison. *An Evaluation of Internal Auditors Responsibility for Detecting Fraud*. Evaluation, Altamonte: The Institute of Internal Auditors Research Foundation, 2008.

⁴³ Flaherty, John. "8th IACC: Role of Internal Auditors in the Anti-Corruption Battle." *8th International Anti-Corruption Convention*. <http://8iacc.org/papers/jflaherty.html> (accessed November 1, 2011).

significant time to legal and regulatory compliance risk, the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act.

Chapter 4: Interview Reed Gardiner

To get a better picture from an auditor's point of view I spoke with Reed Gardiner, a retired auditor at PricewaterhouseCoopers. Reed received both his undergrad and graduate (MBA) degrees at the University of Southern California. In 1971, after graduation, he began working full time as an auditor at PricewaterhouseCooper (PwC). During his time there he has traveled to Taiwan, Saudi Arabia, the United Kingdom and Hong Kong. Within three years he was appointed to manager and after 11 years, in 1982, he was admitted to partner. As a partner, he moved to Saudi Arabia and created a close connection with the key Saudi royal family members; thus allowing PwC to venture into business within the country with several sensitive political and economic sectors. Reed also worked on large clients including Mattel, Purex and Shell Oil. After the Sarbanes- Oxley era he filled a Risk Management Role at PwC where he was required to evaluate and determine the firm's position on the most sensitive and challenging issues facing his audit teams. Reed has travelled the globe working for PWC and has encountered a variety of cultural aspects and differences in other countries.

While talking to Reed his first question to me was, "When a company in the United States makes a contribution to a political party, is it bribery?" This was a great question, which got me thinking; what is actually considered bribery? Every day, companies contribute to political parties or candidates, typically because the parties have opinions that the corporation agrees with; however, this is considered support for the campaign, not bribery. The Foreign Corruption Practice Act is used to prevent direct payments to a politician, but not to private entities or other people; so although there is law to try to prevent bribery, these laws, in Reed's opinion, are to "Prevent wildly embarrassing situations for corporations." He believes these laws

will never fully prevent the act of bribery because in other countries bribery is simply how business runs.

When entering a new business venture in another country, a company needs an agent or a local partner who will help them become credible within the new location help them understand the business and culture of the area, and "Get things done." When dealing with an agent, a company should have them sign documents that state they will not use any funds they receive to pay off other officials; this is documentation that the agent has no knowledge that anything illegal will happen, in the event that it does occur later. Even though agents and local partners sign these documents, it does not mean they will follow them. For instance, Reed shared with me while being the partner on Mattel they had told their suppliers every way possible not to use any paint that contained lead to paint their toys. However, Mattel hit headlines worldwide with recalls for products due to lead paint. The suppliers for Mattel were more focused on cutting costs than following the contracts they signed; this it shows that companies and professionals do not always follow these contracts fully. Agents, regardless of signed documents, may do what they have to do to succeed in to the new location; even if that requires them to pay people off-- which in many countries is exactly how a new company starts in a new area.

My next question turned to auditors-- how do auditors audit companies in locations with fewer regulations? Reed explained when it comes to doing business with other countries it is more about learning to do business in their manner and adapting to it, while not violating your company's code of ethics. When introducing a business into a new location you cannot come in with cookie cutter ethics, because you will not be able to business when other countries have cultural differences. Reed stated that he would not be associated with a potential client that engaged in blatant bribery. When reviewing potentially questionable payments one must look at

two things -- proper authorization for the transaction within the compliance policy, and whether the transaction was recorded properly. If the transaction did not have proper authorization there is problem with internal controls, which are needed to prevent improper payments. If authorization is correct, determine if the transaction was recorded properly. For example, was a bribe mischaracterized as a material expense? Overall, grease payments occur everywhere; however, illegal bribes should be prevented, which is the duty of the tone at the top. If the tone at the top of a company does not fight the illegal bribes, the company is not worth doing business with. Reed explained that the boards' understanding of situations is very important in preventing illegal bribes. If a company's board of directors are the smartest people, but have no street smarts or understanding of the company, the CEO and the CFO can get away with much more than if there is a wiser board.

While at PwC, Reed was in charge of choosing which companies to audit. He had to tell several companies that his would not audit theirs due to the board of directors; if the companies wanted PwC to audit or do compliance work, they must change their board.

Additionally, when auditing a company you need to really know the industry, the average cost of different items, and how close executives are to getting their raises. Having knowledge of these items will allow an auditor to know where they might alter numbers and where to look for things that are not recorded properly. When auditing a company it is very important to understand their tone at the top and how they are adapting new business ventures with other countries.

Overall, Reed's travels have allowed him to understand the culture differences in business compared to those of the United States. One cannot go to another country and do

business with the same way you do business in New York or Los Angeles; you must adapt to the business culture of that location. While the new U.K. Bribery Law will not completely prevent bribery, it will eliminate some of the most blatant bribes.

Auditors have a big part in the detection of bribery; however, there is not much of a history of auditors finding corruption through audits. In a survey done by the Institute of Internal Auditors Research Foundation, internal auditors have 20.78% and external auditors have 11.76% of the responsibility to fight against corruption and fraud, while management is 38.10% responsible for detection of fraud⁴⁴. So, although internal and external auditors have a big impact, the majority of the responsibility relies on the company.

⁴⁴ (DeZoort and Harrison 2008)

Chapter 5: Government Prevention and Detection and Users

Governments

When the FCPA was designed, the SEC authorized it, while the Department of Justice (DOJ) was responsible for enforcing it and the Organization for Economic Co-operation and Development (OECD) is responsible for monitoring the effectiveness. Today there are shifts in the way it is being enforced, as well, many believe it is effectiveness is not sufficient.

Today government is taking a different approach to bring up cases on companies. Earlier the SEC and DOJ aimed at bring cases up against companies, which caused the company to pay a large fine, however this was not effective. In the last 20 years no corporation has challenged either the SEC or the DOJ in a FCPA case, instead they have consented to an injunction neither admitting or denying charges, and the companies have been required to pay large sums of money⁴⁵. In order to have a larger impact, today the SEC and DOJ are focusing on individuals within corporations. The Assistant Attorney General Lanny Breuer, in a speech before a FCPA audience in November 2009, stated, "the prospect of significant prison sentences for individuals should make clear to every corporate executive, every board member, and every sales agent that we will seek to hold you personally accountable for FCPA violations."⁴⁶ Individuals are more likely to dispute the situation since they are losing their liberty and could be punished with prison time. The government has also become more aware of the relationships companies have with their agents. Engaging with an agent and maintain the relationship is exposing potential bribery

⁴⁵ Koehler, Mike. "The Foreign Corrupt Practice Act in the Ultimate Year of Its Decade of Resurgence." *Indiana Law Review*, 2010: 390-412.

⁴⁶ Koehler, Mike. "The Foreign Corrupt Practice Act in the Ultimate Year of Its Decade of Resurgence." *Indiana Law Review*, 2010: 390-412.

since 1977, until now there has been a lack of implementation so why is today any different than the past?

Users

Shareholders are important to business, they are the reason some companies have capital to grow; they take on the most risk, with the possible outcome of losing everything. However, as investors they need to be aware of the potential dangers and problems within each investee company. They should understand the company's past in order to determine what their future may entail.

As due diligence for an investor, they need to research and learn about a company and its business model. What used to be a challenge, one can find out about a company's corporate governance and the rating simply by looking at yahoo finance or similar sites. This is a new development called GRId, it allows users to find out any concerns about the governance of a company and see if there are any key areas to be concerned about. With this an investor can get a good understanding of there the major risks of the company. When doing due diligence investors should consider the risk of corruption within an industry and country and the company's past allegations of corruption⁵⁰. Many companies that have a history of corruption are more likely to have corruption in the future. If already invested, investors can take actions that can support incentives that address corruption. If already invested in a company and they engage in corruption, investors need to consider if the company has taken adequate measures to lower the risk in the future, if there is possibility of more incidents, and if the company's reputation will be affected.⁵¹ If a company's reputation is harmed in a bribery case, the future of

⁵⁰ (Frost and Sarasin 2011)

⁵¹ *ibid*

the stock prices can be greatly altered, lowering the market value and futures hopes of the company.

As well, although companies pay bribes to expand ones business or enter into new sector, this can affect the investors of the company. Even if a company commits bribery they have the obligation to the users to present the most reliable financial statements without misstatement. However, when committing a bribe, many put these expenses into miscellaneous expense or other accounts, misleading the profitability of one's company. This can affect investors both positively and negatively, in the fact that they might not invest in ones company due to high expense or simply mislead the investor with false numbers.

If we look back at the case of Titan Industries, how did the investors react to the situation and how did it affect their investment within the corporation. As you can recall Titan, a leading military intelligence contractor, funneled about \$2 million to the election campaign of Benin's president, a small country in West Africa, to assist in the development of a telecommunication project in Benin⁵². On March 1, 2005 Titan Corporation (TWI) pleaded guilty and agreed to pay \$13 million in fines, as well pay \$15.5 million in disgorgement and prejudgment interest. Although this was a large sum of cash, Titan Industries had annual revenue of about \$2 billion, thus a \$30 million fine was not very material and had little effect on the market price. When compared to the Bloomberg EMEA Aerospace/ Defense Index the price increased⁵³. However, when the scrapping of the Lockheed Martin Corp merger was announced the stocks prices fell

⁵² Welner, Tim. "Titan Corp. to Pay \$28.5 Million In Fines to Forgin Bribery." *New York Times*. 2 March, 2005. <http://www.nytimes.com/2005/03/02/business/02titan.html> (accessed December 2, 2011).

⁵³ Frost, Adam and Sarasin. "http://www.worldwiseinvestor.com/news/article/132/Corruption---Sarasin-&-Partners-Responsible-Investment-Research." *Worldwise Investor - Corruption - Sarasin & Partners Responsible Investment Research*. October 5, 2011. <http://www.worldwiseinvestor.com/news/article/132/Corruption---Sarasin-&-Partners-Responsible-Investment-Research> (accessed December 2, 2011).

20%⁵⁴. Although the investors were not directly affected by the allegations by the SEC, the failure of the merger had a major impact. Smaller companies may be affected differently by allegations, than larger corporations. Smaller companies have lower revenues, thus when hit with millions of dollars in fines; their impact will be more substantial. Investors are both affected by losses in nominal value, as well as arbitrary values such as the trust one has in a company. The investors need to be sure to investigate the background of a company before investing to ensure this will not affect them in the future.

While talking to Reed, I asked him about his feelings about users and investors and if they should be concerned about companies and bribing, he stated they need to be aware of the company and their situations. When investing you need to know if they have had high bribes in the past and what their plans for the future are. However, he did not really go to much detail on the aspects of investors and bribery except that they need to be aware it is everywhere.

Investors and users of financial statements can be affected drastically or minimally, pending how the market and world reacts to the news. In recent situations, investors specifically have not been extremely affected, but every situation is a new story. Investors can take precaution before investing in companies, and if invested promote act to prevent harmful actions.

Chapter 6: Conclusion

I have come to conclude that the SEC, DOJ and the OECD are not taking bribery as seriously as they have stated. When writing the FCPA the law purposely excluded “grease payments,” a bribe. So until they eliminate all types, bribery will not get better. With the numerous ways to prevent and detect bribery, such as step by step frameworks and analysis programs, companies are still not able to implement the programs effectively. Looking at the statistics of companies, one in three US and UK companies incorporate employee training more than once a year and three in five required agents to participate in the training. Agency and ethics of employees are a major risk within companies, if they are not educating with the policies of a company and know the proper procedures, bribery will not be minimized. Until companies fully implement their programs throughout the entire corporation nothing will improve.

Many believe the UK Bribery Act will decrease bribery stating it is “the FCPA on steroids,” however, very few know what the law entails. However, in the UK Bribery Act “cultural” norms, in essence a bribe, is allowed, just as “grease payments are allowed in the FCPA. 80% of top management, in a study done by KPMG, stated they have little to no knowledge about the UK Bribery act, with UK management 32% had little knowledge. This shows that people are not aware of the changes and are not changing the programs to better inline their programs. Without the efforts of companies to abide by the laws prevention will never get lower. As well, until elements of cultural norms are eliminated, bribery will still be present. Everyone, worldwide, needs to comes together to actively prevent bribery.

Companies are being directly affected by bribery, losing out on deals due to other companies bribing, but they lack implementation of their prevention programs. As well, the

companies are scared to enter into new business ventures with companies who have not operated under the FCPA, since the SEC is cracking down on the laws. Although users can be affected by changes in stock prices, or a company's reputations being destroyed, overall this still has a direct affect on companies. They need to become more aware and take a more initiative in prevention.

Avon Case Study- Bribery and Ethics

Background

Avon Products (AVP) is one of the world's top direct manufacturers and marketers of cosmetics and beauty related items with an annual revenue of over \$10 billion. The company does not sell through third party retail establishments (drug stores, department stores). Avon primarily sells through one main channel, direct selling through 5.5 million independent Avon Sales Representatives, however, it also utilizes catalogues and a website to distribute products. It is in a highly competitive beauty industry and compete against other consumer packaged goods and direct selling companies.¹ They have three categories of products: Beauty, Fashion, and Home. Beauty goods consist of color cosmetics, fragrances, skin care and personal care. Fashion consists of fashion jewelry, watches, apparel, footwear, accessories and children's products. Home consists of gift and decorative products, house wares, entertainment and leisure products and nutritional products.²

Avon sells and distributes goods in over 100 countries. In recent years, through acquisitions and mergers, it is expanding its product line. In 2005 Avon expanded into China, a big gain for the company since in 1998 China banned direct-selling. However, Avon was given the approval by the government to test out areas, specifically Beijing and Tianjin.³ In 2006, Avon was the first company to receive a direct- selling license in China. Then in 2010 it purchased Silpada, a sterling silver jewelry company, following that they bought UK based Liz Earle

¹ *Avon 2011 Financial Statements*. Form 10-k, New York: Avon, 2012.

² *Ibid*

³ Colbert, Catherine. "Avon Products, Inc." *Hoovers*. 2012. <http://0-subscriber.hoovers.com.library.uor.edu/H/company360/overview.html?companyId=10152000000000> (accessed April 8, 2012).

Beauty, which develops skin care products and Tiny Tillia brand, a bath and body care products for babies.⁴

Ethics in Business

Ethics is a very important in business, and in the accounting profession. A few unethical actions can put an entire company out of business, such as Arthur Anderson, a huge international accounting firm. Ethical behavior is essential for the functioning of our economy.⁵ Without it the economy would operate less efficiently—less would be available to consumers, quality would be lower and prices would be higher.⁶ As James Surowiecki states, “If you assumed every potential deal was a rip-off or that the products you were buying were probably going to be lemons, then very little business would get done. More important, the costs of the transactions that did take place would be exorbitant, since you’d have to do enormous work to investigate each deal and you’d have to rely on the threat of legal action to enforce every contract.”⁷

Foreign Corrupt Practice Act

The Foreign Corrupt Practice Act (FCPA) went into law on December 19, 1977, after the uncovering of millions of bribes within United States companies. The FCPA has two main provisions: the accounting provision and the anti- bribery provision. The accounting provision requires companies to maintain detailed and strict recordkeeping and internal controls. This requires that all issuers "make and keep books, records, and accounts, which, in reasonable

⁴ See Colbert, note 3. *supra*.

⁵ Garrison, Ray, Eric Noreen, and Peter Brewer. "Managerial Accounting 12e." 2-29. New York: McGraw Hill Irwin, 2008.

⁶ *Ibid*

⁷ *Ibid*

detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." ⁸

The anti-bribery provision prohibits bribery of foreign officials, political party officials, and candidates for political office to obtain business, directing business to others, or securing any improper advantages, for all companies registered or not registered with the SEC. Bribery is defined as any offer of payment to any foreign official with the knowledge that the payment will sway their decision, cause them to omit or to do an act in violation of his duty, or to secure any advantages with a country.⁹ However, there are some exceptions to "grease payments" made to foreign officials, such as securing the performance of a "routine governmental action."

Avon Scandal

In June 2008, Avon Products, Inc.'s Chief Executive, Andrea Jung, received an allegation that certain travel, entertainment and other expenses may have been improperly incurred in their China operations. On October 20, 2008 Avon began to voluntarily conducted an internal investigation, under the oversight of the Audit Committee. The investigation was focused on China operations and the compliance with the Foreign Corrupt Practice Act (FCPA), both the SEC and the DOJ were notified of the situation. Although the scope of the investigation was originally on China, it soon widened to include their Latin America, India and Japan operations.

Prosecutors are investigating previously reported internal auditor's findings, and whether or not Avon headquarters took actions in relation to the report. A 2005 internal audit reports identifies several hundred thousand dollars of alleged purchases of trips to France, New York, Canada and Hawaii for Chinese officials and third parties when Avon was applying for a license

⁸ Jordan, Jon. "Recent Developments In The Foreign Corrupt Practices Act And The New UK Bribery Act: A Global Trend Towards Greater Accountability In The Prevention Of Foreign Bribery." *NYU Journal of Law & Business*, 2011.

⁹ Ibid

to engage in direct sales in China, warned Avon's actions may in violation of the FCPA.^{10,11} Ultimately, investigators also turned up millions of dollars of questionable payments to officials in Brazil, Mexico, Argentina, India and Japan in amounts that are significant.¹²

In April 2010 four executives were suspended as a result of being suspected to have paid bribes to officials in China, but were not publically accused of wrongdoing. Three executives, S.K. Kao, president of the Chinese unit; Jimmy Beh, its chief financial officer; and C.Q. Sun, head of the corporate affairs and government relations group, were people familiar with the matter.¹³ The fourth was Ian Rossetter, Avon's former head of internal audit, who started a special assignment in mid-2009, reporting to Avon Chief Financial Officer Charles Cramb.¹⁴ No term as of the date of this writing as a result of further investigation into Latin America, India and Japan.

Code of Business Conduct and Ethics/ Global Anti- Corruption Program

In 2008 at the start of the new investigation, Avon set out a new Code of Conduct and Ethics. The purpose is to summarize the firms policies and practices to promote ethical and lawful behavior of its associates. It focuses on areas of ethical risk and provides guidance on the appropriate action for the situations. A couple areas, as it relates to bribery, are conflict of interest, acceptance of gifts, loans and entertainment, and improper payments and bribery. It

¹⁰ China Briefing. "Avon Bribery Case May Face U.S. Grand Jury Investigation." *China Briefing*, 14 February, 2012: <http://www.china-briefing.com/news/2012/02/14/avon-bribery-case-may-face-u-s-grand-jury-investigation.html#more-15630>.

¹¹ DuJua, Chen. "US prosecutors present evidence in Avon case." *Global Times*. February 16, 2012. <http://www.globaltimes.cn/NEWS/tabid/99/ID/696110/US-prosecutors-present-evidence-in-Avon-case.aspx> (accessed April 3, 2012).

¹² Byron, Ellen. "Avon Bribe Investigation Widens." *Wall Street Journal*. May 5, 2011. <http://online.wsj.com/article/SB10001424052748704322804576303302214411400.html?KEYWORDS=avon> (accessed April 11, 2012).

¹³ Byron, Ellen, "Avon Suspends Four Executives Amid Bribery Probe," *The Wall Street Journal*, (Apr. 13, 2010), <http://online.wsj.com/article/SB10001424052702304506904575180501075099806.html>.

¹⁴ Ibid

provides guidance on items such as company assets, acceptance of gifts, etc. To read in detail go to: <http://www.avoncompany.com/corporatecitizenship/corporateresponsibility/corporateresponsibilitypractices/ethics-complicance/index.html>. Within these sections it gives details on how to handle such situations as they occur.

In 2010, Avon also launched its current Global Anti-Corruption Program. This program focuses on Avon's commitment to comply with the FCPA and other anti-corruption laws, as well, it provides detailed guidance on appropriate transactions with non- US Governments.¹⁵ One of the key components is the Third- Party Anti- Corruption Review Process, which looks at the corruption risk of each third party and ensures their compliance with all corruption laws. Avon has also required select associates to do in- person training, focusing on Avon's policies and procedures and compliance programs. For the other associates, with Avon e-mail accounts, they will complete the company's tailored on-line anti-corruption e-training module.

Conclusion

Avon has made some great changes since the initial hearing of possible bribes; however, in the future they can still be affected. Avon's future strategic planning in China, including market expansion, competition strategy and staff recruitment can be significantly affected.¹⁶ If Avon was qualified for their direct sales licenses in China, they will punish those for bribery; however, if they were unqualified and received the licenses it will be revoked. This will really hurt Avon; since they are sales over the past years have fallen with the economy.

¹⁵ "Global Anti-Corruption Program." *Avon*. 2012.

<http://www.avoncompany.com/corporatecitizenship/corporateresponsibility/corporateresponsibilitypractices/ethics-complicance/anti-corruption-policy.html> (accessed April 2, 2012).

¹⁶ See DuJuan, note 9, *supra*.

Complying with the FCPA is a tricky issue for U.S. companies with connections to China. “While treating government officials to business dinners and entertainment could be regarded as FCPA noncompliance, in China it is often seen as a common way for businesses to manage their “*guanxi*,” (relationship) with local authorities.”¹⁷ China requires a strong relationship for business transactions to be accomplished, so without the payments, Avon might not have been able to begin business. Bribing of the officials could be a key aspect for Avon to receive their licenses in China. However, the ethics of the business have been damaged and they now must reconstruct their management and company confidence.

¹⁷ See China Briefing, note 8, *supra*.

Questions:

1. What was Avon lacking that allowed this to happen? Consider tone at the top and specific control processes.
2. Assume the president and other top executives knew their acts were illegal, but also knew payments were necessary to enter China. What would you have done in their situation?
3. It appears Avon did not take action in 2005 with the information from the internal auditors. Why do you think they waited till 2008 to start an investigation?
4. Do you think the new Code of Business Conduct and Ethics/ Global Anti- Corruption Program will be effective for the future? If no, explain.

Assignment for Students

- Have students design internal controls that would help detect and eliminate bribery. Using the six step program designed by Transparency International or the Ministry of Justice have the students create an anti- corruption program.
 - a. For Avon
 - b. For another company that students are comfortable with.

Appendix

The Ministry of Justice guide on the adequate procedures deemed necessary to defend a charge of negligently failing to prevent a bribe.

Principle 1- Proportionate procedures:

- The Authority/Constabulary's procedures to prevent bribery by persons associated with it are proportionate to the bribery risks it faces and to the nature, scale and complexity of the organization's activities. They need to be clear, practical, accessible, effectively implemented and enforced.

Principle 2- Top level commitment:

- The top level management of the Authority/Constabulary is committed to preventing bribery by persons associated with it, fostering a culture within the organization in which bribery is never acceptable. This can be demonstrated by:
 - o Getting involved in developing the anti-bribery stance and being able to demonstrate such
 - o Leading by example.

Principle 3 - Risk Assessment:

- The Authority/Constabulary assesses the nature and extent of exposure to potential external and internal risks of bribery on its behalf by associated persons. The assessment is periodic, informed and documented. Considerations should be given to:
 - o Looking at procurement and commercial activities- what is bought/sold/supplied, to/from and how?
 - o Country/Sector/Transaction/Business Opportunity/Business Partnerships
 - o Documenting your decision-making and re-visiting regularly.

Principle 4 - Due diligence:

- The Authority/Constabulary applies due diligence procedures, taking a proportionate and risk-based approach, in respect of persons who perform or will perform services for or on behalf of the organization, in order to mitigate identified bribery risks. Consideration should be given as to:
 - o Who performs services and how one can be re-assured (or not) that they will not bribe on your behalf
 - o Recruitment, HR and partnering processes – ensuring that the checks made are proportionate to the risk
 - o Previous history/track-record and financial indicators of distress/pressure.

Principle 5- Communication (including training):

- The Authority/Constabulary seeks to ensure that its bribery prevention policies and procedures are embedded and understood throughout the organization through internal

and external communication, including training that is proportionate to the risks it faces.

Consideration should be given to:

- Who needs to be informed of the anti-bribery stance
- the content, language and tone...it may very well need to be tailored to suit
- How best can it can be rolled out (face to face, e-learning, internet)
- Reminders of stance, ethics, policies, processes and how to report concerns.

Principle 6- Monitoring and review:

- The Authority/Constabulary monitors and reviews procedures designed to prevent bribery by persons associated with it and makes improvements where necessary.

Consideration should be given to:

- Revisiting as often as proportionate; business changes and so do the risks
- Monitoring transactions again in proportion to the risk
- Getting external re-assurance that what you are doing is adequate.

Transparency International- Six Step Implementation Process

Step 1: Decide On A No-Bribes Policy And On Implementing A Programme

"Making the case"

- Deciding on a no-bribes policy
- Getting commitment from the top
- Setting up a cross-functional Project Team
- Deciding the extent of any public disclosure
- Focusing on meeting the timetable
- Identifying obstacles to a decision at Step 1

Step 2: Plan The Implementation

"Setting the framework"

- Drafting the no-bribes policy
- Evaluating exposure to risks of bribery
 - **Reviewing all legal requirements**
- Developing and writing the anti-bribery Programme
- Testing the written Programme

Step 3: Develop The Programme Content

"Filling out the Programme"

- Integrating policy into organisation structure and assigning responsibilities
- Reviewing the capacity of support functions
- Reviewing the capacity of operational functions
- Adapting the HR policies
- Developing and implementing training programmes
- Developing the communications strategy
- Establishing the advisory and issue raising functions
- Setting up recognition and sanctions processes
- Preparing for incidents

Step 4: Implement The Programme

"Getting it working"

- Communicating the new policy
- Implementing training programmes
- Ending the initial implementation process

Step 5: Monitor

"Is it working?"

- Monitoring the system
- Capturing experience
- Obtaining external verification

Step 6: Evaluate The Programme

"How can we improve?"

- Receiving feedback from the monitoring process
- Deciding on improvements to the anti-bribery Programme
- Publishing results of the evaluation process

For Full Implementations Programs

"Bribery Act 2010." *Ministry of Justice*. April 8, 2010.

<http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf> (accessed April 3, 2012).

"TI Six Step Implementation Process." *Transparency International*. 2012.

http://www.transparency.org/global_priorities/private_sector/business_principles/six_step_implementation_process (accessed April 2, 2012).

